Greater Toronto Real Estate Report

Asset Focus: Office Buildings

December 5th, 2006 Volume #12.06

SOLD BY Pierre Gagné - 75 Eglinton Avenue East, Toronto, Ontario
A site of approximately 15,495.8 square feet improved with a 74,681gross square foot seven storey **office building** located on the southwest corner of Eglinton Avenue East and Dunfield Avenue two blocks east of Yonge Street in Toronto, Ontario. Closed on November 30th, 2006 at $9,360,000 or $125.33 per square foot.

NEW LISTING – CHURCH PROPERTY

5920 Montevideo Road in Mississauga, Ontario.
A 1.86 acre site located south of Highway 401, west of Erin Mills Parkway in Mississauga improved with a two level 8,008 square foot building built circa1988.

- MINIMUM BID PRICE: $1,600,000
- Offer Due Date: February 19th, 2007 at 12:00 Noon.

Click to find out more or visit www.gagenrealestate.ca/Montevideo.php

OTHER RECENT OFFICE BUILDING SALES IN TORONTO

Source: Marshnet

2206 Eglinton Ave. East – A 150,000 square foot building located west of Birchmount Road east of Warden Ave. in Scarborough. Closed on November 14, 2006 at $43,063,530 or at $287 per square feet.

1380 Don Mills Road – A 51,665 square foot building located north of Lawrence Ave. south of York Mills Road. Closed on November 6, 2006 at $6,600,000 or at $128 per square feet.

155 Gordon Baker Road – A 224,625 square foot building located just north of McNicoll Ave. south of Steeles Ave. East and can be seen from Highway 404. Closed on November 3, 2006 at $22,250,000 or at $91 per square feet.

1500 Don Mills Road – A 218,644 square foot building located right on the corner of Don Mills Road and York Mills Road. Closed on November 2, 2006 at $32,750,000 or at $150 per square feet.

355 Adelaide Street West - A 24,000 square foot building located on the south side of Adelaide Street just east of Spadina Ave. Closed on September 8, 2006 at $6,000,000 or at $250 per square feet.

491 Eglinton Ave. West –A 36,544 square foot building located west of Avenue Road, east of Bathurst Street. Closed on August 18, 2006 at $5,800,000 or at $159 per square feet.

150 Ferrand Drive – A 261,000 square foot building located east of Don Mills Road south of Eglinton Ave. Closed on August 10, 2006 at $17,800,000 or at $68 p.s.f.

200 Ronson Drive – A 125,591 square foot building located on the east side of Martin Grove Road in Etobicoke. Closed on August 8, 2006 at $13,050,000 or at $104 per square foot.

40 Sheppard Ave. – A 110,000 square foot building located on the west side of Yonge Street at Beecroft Road. Closed on July 10, 2006 at $14,225,000 or at $130 per square foot.

17 Toronto Street West – A 55,800 square foot building located on the east side of Yonge Street just south of Adelaide Street. Closed on June 30, 2006 at $7,000,000 or at $125 per square feet.

INDUSTRY COMMENTARY – LAND LEASES

We have researched a total of eighteen sales involving land leases which have occurred since 2000. Only three of these sales were sales of the fee simple interest to a third party other than the leaseholder; twelve sales were sales of the fee interest to the leaseholder; and three sales were sales of the leasehold interest. Yields on the land leases varied widely, from 0.28% to 11%, but the median is 4.5% to 5.0%.

The relatively low returns are easily explicable. Firstly, the theory suggests that the cap rate required for an income producing property allows for both a return "on" capital and a return "of" capital. Land leases need to provide only for a return on capital, since there is no building to depreciate and the return of the capital is guaranteed at the end of the lease term. For example, where an office building might sell at a 7.0% cap rate, and be fully depreciated over 50 years, the underlying land might justify a lower return of, say, 5.0%.

Click here for more

Life Lessons at P.G. Gagné Commercial Real Estate Corp., Brokerage – Lesson #20

What you look for in life tends to be what you end up seeing and you must strive to focus on the good things in the world around you rather than the bad. Perspective is all important: look at life from a positive angle and positive things are more likely to happen.

Source: My Horoscope Today

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INDUSTRY COMMENTARY – LAND LEASES

We have researched a total of eighteen sales involving land leases which have occurred since 2000. Only three of these sales were sales of the fee simple interest to a third party other than the leaseholder; twelve sales were sales of the fee interest to the leaseholder; and three sales were sales of the leasehold interest. Yields on the land leases varied widely, from 0.28% to 11% due to varying circumstances, but the median is 4.5% to 5.0%.

The relatively low returns are easily explicable. Firstly, the theory suggests that the cap rate required for an income producing property allows for both a return "on" capital and a return "of" capital. Land leases need to provide only for a return on capital, since there is no building to depreciate and the return of the capital is guaranteed at the end of the lease term. For example, where an office building might sell at a 7.0% cap rate, and be fully depreciated over 50 years, the underlying land might justify a lower return of, say, 5.0%.

Secondly, the low maintenance requirement and the potential reward of owning a building at the end of the term (or earlier through rental default) are other reasons to justify lower returns. Land leases offer investment characteristics similar to bonds, in that they pay regular returns and provide the promise of the return of capital at the end of the investment horizon. Investments in the bond market are priced lower than other investment alternatives in the riskier equity markets. The thirty-year Canada's for example, is trading today at less than 4.1% and the real return bonds that are adjusted for inflation are priced at 1.6% Nonetheless, provide rental increases in land leases and the return of corporate inflation adjusted numbers provide returns well above bond like returns.

Finally, the buyer of leased land is often the leaseholder who has a vested interest in combining both fee simple interest and the leasehold interest to enhance the value, marketability and financeability of the leasehold interest and who is therefore prepared to accept a lower return on the land than a third party might.

As a matter of interest, today's sales are based on lease agreements negotiated as far back as the 1950's. Experience suggests that tax deferral motives and long term strategic issues were the driving forces that justify land lease structures for the fee simple owner. Leaseholders for their part might have valued the financial leverage afforded in the development of a leasehold income property and/or might have valued the fact that the site would not have been available for an outright purchase otherwise.

There is no consistency in the rental rate formulas and terms vary widely. There are various attempts to adjust for inflation. Some lease structures allow for predetermined interval increases assuming a set inflation rate while other leases allow for periodic land value reassessments that will generate returns at a fixed and predetermined rate of return. A few leases also permit a participation in the income generated by the building.

When reviewing these transactions, I ask myself how the lease structure may allow the owner of the bundle of rights to monetize its interest creatively today in ways other than the conventional mortgaging or disposition of the entire bundle of rights.

What benefits can an owner enjoy by selling or keeping a newly created leasehold interest while keeping or selling the fee simple subject to the land lease? I am available to discuss strategies with you on specific asset requirements.

My summary table of analysis is available to those who will make a request for it.